Central Intelligence Agency

Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

6 April 1983

Nigeria: Further Economic Deterioration [redacted] 25X1

Summary

Nigeria's financial position has deteriorated since we examined the economy [redacted] That assessment predicted that the country's economic difficulties would become more severe in the months leading up to the mid-1983 general elections, but that the government probably could avoid implementing politically difficult austerity measures until after completion of the voting. Since that assessment, the world oil market has continued to soften and nominal crude prices have fallen. Under current conditions, Nigeria in 1983 will have to cut import spending by at least 30 percent in real terms to hold this year's current account deficit under $4 billion, the largest amount that Lagos can finance on international markets. [redacted] 25X1

For the moment, Lagos will not lower prices to keep strict parity with recent North Sea price cuts, despite its previous pledge to do so. Nigeria, along with other oil producers, is hoping that the international oil market will stabilize at this new price level and production and exports will pick up. Should the market not improve and North Sea prices fall significantly below the current $29.85 per barrel rate, Lagos will have little choice but to match North Sea cuts in order to maintain its share of the market. If prices should fall precipitously--perhaps to $20 per barrel--Lagos would have to implement import cuts of such magnitude that the modern sector of the economy would be badly damaged. [redacted] 25X1

This memorandum was prepared by [redacted] *West/East Africa Research Branch, West/East Africa Division, Office of African and Latin American Analysis. It was coordinated within the Directorate of Intelligence and the National Intelligence Council. Information available as of 1 April was used in its preparation. Comments are welcome and may be directed to the Chief, West/East Africa Division,* [redacted] 25X1

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Soft Oil Market Forces Nigeria's Hand

The continuation of weak oil market conditions and Nigeria's lack of price competitiveness with similar North Sea and Libyan crudes caused oil production to plummet in the first two months of this year--traditionally the period of highest demand for Nigerian oil--to the lowest levels since the end of the 1967-1970 civil war. Output in this period averaged only 70 percent of the 1 million barrels per day on which the budget is based and was less than half that produced in the same period in 1982. Production by mid-February had dropped to 430,000 barrels per day--one fifth of capacity. US Embassy sources report that if output had remained at that level for the remainder of the year, oil receipts--which provide over 95 percent of total foreign exchange earnings--would not cover even the cost of food imports and debt servicing. [redacted] 25X1

Pressure on Lagos to lower the cost of its oil intensified following the decision by the British on 18 February to reduce prices by $4 per barrel. President Shagari responded two days later by cutting Nigeria's oil prices by $5.50 per barrel and raising profit margins for oil companies operating in Nigeria by 25 percent to $2 a barrel. The US Embassy in Lagos reports that the companies responded to these moves by boosting output to just under 1 million barrels per day. Most of the oil, however, was pumped into storage facilities instead of exported because customers wanted to wait for the results of OPEC deliberations on new price and production guidelines. We believe that OPEC's recent pricing and production agreement has failed to renew demand because buyers still have one to two months' worth of stocks on hand and would prefer to draw them down in anticipation of further price cuts. [redacted] 25X1

We believe that Nigeria's ability to raise its production to the level of 1.3 million barrels per day specified in the latest OPEC agreement will depend on how flexible Lagos is with its pricing policies. The government has stated publicly that it will match price cuts implemented by the United Kingdom and other producers of North Sea crude, Lagos' principal competitors. The UK late last month lowered its per barrel prices to an average of $29.85, which Nigeria says it will accept. Embassy reporting indicates that if the North Sea price falls much below $30 a barrel, Lagos will call an emergency OPEC meeting to work out another pricing strategy.

[redacted] 25X1

SECRET

Nigeria is reassessing its oil sales policies as well. The Shagari administration has set up an ad hoc committee, headed by the Minister of Agriculture, to devise a more aggressive strategy for securing customers on a long-term basis. When the world oil market tightened in 1979, the Nigerian National Petroleum Corporation chose to sell a larger share of its crude to Third World governments and limit individual purchasers to no more than 50,000 barrels per day. Now that the oil market is soft, the government is looking to ensure more stable sales. Shagari's principal Energy Adviser, Alhaji Yahaya Dikko, traveled to Western Europe and the United States in February to sound out foreign company producers of Nigerian oil and other consumers about longer term purchase deals. 25X1

Adjusting to Reduced Revenues

Even if Nigeria is able to keep production at its quota for the rest of the year, daily output for the year will average 1.2 million barrels, slightly below last year's level. Oil revenues, however, will be down by over 20 percent, assuming no change in the latest price levels. This drop in earnings means that the government must make even more painful adjustments in import spending than the restrictions imposed last April. To limit the current account deficit to $4 billion--the maximum amount that we believe Nigeria can cover--Lagos will have to cut imports in real terms by 30 percent and limit service expenditures to little more than shipping charges for overseas goods and interest payments on medium- and long-term debt. Some international bankers question Nigeria's ability to come up with $4 billion unless President Shagari signs an agreement with the International Monetary Fund. The government so far has strongly resisted such a move, believing that the Fund will demand a currency devaluation and other measures that are politically unacceptable, particularly in an election year.

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Any additional decline in oil prices would make the adjustment process even more painful. A fall to $20 per barrel, for example, would cost an additional $3.2 billion in revenues. To offset this loss, Lagos would have to decrease import flows by 50 percent. We believe that a reduction of this magnitude would have serious repercussions for the modern economy, particularly industrial production. Capital and intermediate goods absorb the bulk of Nigeria's import needs--nearly 75 percent of the total, according to our estimates. 25X1

Sources of government monies are limited. Foreign reserves are slightly more than $1 billion--roughly one month's worth of imports at the current rate[1]--and only about $1.7 billion remains undisbursed on previously arranged credits. Nigeria has been looking for bilateral assistance to help fill the gap. For nearly a year, Lagos has been exploring the possibility of obtaining funds from Saudi Arabia, [redacted] we believe that Shagari had second thoughts about how Nigeria's sizable non-Muslim population--most of whom belong to the political opposition--would react to his accepting money from the Saudis. [redacted] 25X1 25X1 25X1 25X1

[redacted] The US Ambassador to Nigeria reports that Lagos wants to arrange as much financing as possible before resorting to IMF borrowing and its associated conditions. [redacted] 25X1 25X1

In the meantime, government austerity measures are having an increasingly severe impact on the economy. US Embassy reporting indicates that import restrictions are taking their toll on the availability of raw materials and manufactured goods. The automobile assembly industry is one of those hardest hit by the lack of spare parts. The Peugeot factory in Kaduna--Nigeria's second largest--has stopped production for two weeks because it does not have parts and France will not extend additional credits until the $240 million owed for past deliveries is paid. The Volkswagen plant in Lagos periodically closes for several days at a time and production now is only one-third of the normal rate. [redacted] 25X1

[redacted] 25X1 *as Shagari's import-cutting austerity measures took hold in the first quarter, import volume declined enough so that $1 billion in foreign exchange will now finance one month's worth of imports.* [redacted] 25X1 25X1

We believe that the continued economic slowdown has boosted unemployment in the urban areas. Various Nigerian labor and industrial organizations estimate that last year at least 45 industries closed or laid off employees, displacing between 50,000 and 150,000 workers. These same sources report that the expulsion of illegal aliens from Nigeria earlier this year created 55,000 job vacancies at the ports and in construction, but in our judgment many of these positions have not been filled because of the downturn in economic activity, the accompanying slump in demand for services, and the reluctance of Nigerians to accept low-paying positions. [redacted] 25X1 urban unemployment may be as high as 30 percent, double what it was a year ago. [redacted] 25X1

Austerity has had an impact on essential consumer imports as well. In an effort to maintain imports of rice--an urban dietary staple--at normal monthly rates of 60,000-70,000 metric tons, Nigeria is switching from its traditional rice supplier, the United States, in favor of lower quality, less expensive Thai rice. Bangkok also is offering favorable credit terms. [redacted] 25X1 the Embassy in Lagos reports that in recent months Thailand has captured nearly two-thirds of the Nigerian market. US sales of corn and wheat, which account for the bulk of Nigeria's imports of these commodities, also have fallen. According to US Embassy reporting, flour mills are operating at 50 to 70 percent of capacity, and new licensing regulations have cut down on the volume of corn imports. [redacted] 25X1

Tough Decisions Ahead

In our opinion, the Shagari government is increasingly concerned about preventing the deteriorating economy from becoming a major issue in this summer's elections, now scheduled to begin 6 August. According to recent Embassy reporting, prices on staple foodstuffs--particularly rice, yams, chickens, and palm oil--have soared, and the cost of a typical Nigerian market basket has risen by 65 percent since January. Although there has been little economically-inspired unrest thus far, press reporting indicates work stoppages are spreading among such groups as employees of state governments and petroleum workers. Local distribution of petroleum products has already been disrupted in several cities. These developments come at a time when the election campaign is getting into full swing and could provide Shagari's opponents with ammunition for the campaign. [redacted] 25X1

In the absence of an unanticipated sharp increase in oil sales, we believe Shagari's economic options are limited.

--Additional austerity measures would probably spark labor and public unrest, particularly if they contained across-the-board salary cuts for civilian government workers. Reductions in the military payroll are unlikely because of the administration's hope to avoid antagonizing the Army during the sensitive election period. Further cuts in imports will only compound the problem of business closings and rising urban unemployment. 25X1

--Going to the IMF will require structural adjustments in the economy, especially a devaluation. A devaluation, however, would further strain already scarce foreign exchange resources and boost inflation. Such a move--particularly if accompanied by a debt rescheduling exercise--also would be cited by Shagari's opponents as the most graphic sign yet that the government has squandered the country's oil wealth. 25X1

Likely Outcome

It is our judgment that the economy will be one of Shagari's most worrisome problems between now and the elections scheduled for August. An increasing preoccupation with winning what looks to be a tense campaign, however, probably means that he will be less interested in keeping close tabs on financial developments. As a result, we anticipate that the government will do what it can to keep open the flow of essential consumer goods and maintain timely payments of medium and long-term debt service costs, especially interest. Lagos also will continue to seek new credits on international financial markets or, if not successful, add to its already sizable volume of commercial arrears. We believe that the Nigerians will avoid a public appeal for IMF assistance, although we cannot rule out the possibility that they will sound out the Fund privately as to what conditions must be met. 25X1

All of these plans could be jeopardized, however, by a further drop in oil prices. Shagari cannot afford the massive urban unemployment and civil unrest that we believe could result from another substantial loss of government oil revenues. In this situation, we believe that Shagari will have little choice but to go to the IMF, regardless of his misgivings about the political consequences of such a move. We also anticipate that Lagos will intensify its efforts to obtain US help in persuading the Fund to soften its requirements for an agreement. 25X1

Nigeria: Current Account Scenarios, 1983

		Oil production in million b/d	
		1.3	1.2
		Current Account Balance (Billion US $)	
	$30.00	-2.7	-3.8
Nigerian oil price	$25.00	-4.6	-5.5
	$20.00	-6.5	-7.2

Projections assume: 1) A 33-percent drop in real import growth, 2) Domestic oil consumption of 266,000 b/d, 3) Demand for Nigeria's non-oil exports, $0.5 billion, is not sensitive to rates of economic recovery, 4) Import price inflation is 3 percent. 5) Freight and insurance costs are 13 percent of import costs, and 6) Net investment income receipts, interest payments on debts, other services, and private transfers total $-2.1 billion.

Nigeria: Change in Real Imports That Would
Hold 1983 Current Account Deficit to $4 Billion

		Oil production in million b/d 1.3	1.2
	$30.00	-27.6%	-33.1%
Nigerian oil price	$25.00	-37.3%	-42.1%
	$20.00	-46.9%	-51.2%

Projections assume: 1) A 33-percent drop in real import growth, 2) Domestic oil consumption of 266,000 b/d, 3) Demand for Nigeria's non-oil exports, $0.5 billion, is not sensitive to rates of economic recovery, 4) Import price inflation is 3 percent. 5) Freight and insurance costs are 13 percent of import costs, and 6) Net investment income receipts, interest payments on debts, other services, and private transfers total $-2.1 billion.

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